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UNCLAS SECTION 01 OF 02 BRASILIA 002921

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SENSITIVE

STATE PASS OPIC FOR MRUBIO, BMCQUIRE, MABBAY  
STATE FOR EB/IFD/OIA  
USDOC FOR 4332/ITA/MAC/WH/OLAC/JANDERSEN/ADRISCOLL/MWAR D  
USDOC FOR 3134/ITA/USCS/OIO/WH/RD/DDEVITO/DANDERSON/EOS LON

E.O. 12958: N/A

TAGS: [EINV](#) [ECON](#) [PGOV](#) [BR](#)

SUBJECT: NEXT STEPS ON OPIC-RELATED INVESTMENT PROBLEM IN  
SANEPAR

REF: A) BRASILIA 808 - Notal B) OPIC EMAILS

[11.](#) (SBU) Summary: The case of Parana State sanitation utility SANEPAR, in which the U.S. Overseas Private Investment Corporation (OPIC) holds an indirect \$18 million stake, remains a potential problem in the bilateral relationship. The Brazilian Federal Government (GoB) repeatedly has said that it has no legal leverage over the Governor of Parana State, Roberto Requiao, who has abrogated a Shareholders Agreement that gave private shareholders in SANEPAR some say over management decisions and diluted their ownership stake (reftels). Legal action challenging the abrogation has been dragging through state-level courts, which the private shareholders fear have been subject to political pressure. Given substantial French and Spanish holdings in SANEPAR, Post proposes further action on parallel tracks: 1) a joint French-Spanish-USG approach to the GoB; and, 2) pursuit, by the private shareholders, of action through the Brazilian SEC-equivalent (CVM) to challenge the dilution of the private shareholder stake. End Summary.

[12.](#) (SBU) Background: OPIC, through a credit to the Global Environmental Emerging Markets Fund II (GEEMF II), is a financial investor in a joint venture called Domino, which in turn holds a minority stake in SANEPAR. In addition to GEEMF II, the Domino consortium include Proactiva (a joint venture of French multinational Vivendi and Spanish firm FCC), Brazilian construction company Andrade Gutierrez, (Brazil's largest construction firm) and Opportunity Daleth, another financial investor (which includes a CitiBank hedge fund). The GEEMF II invested \$18 million in SANEPAR, via Domino, during a 1998 privatization, in which Domino obtained 39.7% of SANEPAR shares. Domino's minority stake gave it, through a Shareholders Agreement, the right to nominate three of the seven SANEPAR executive officers. In February 2003, newly-elected Parana governor Requiao unilaterally abrogated the Shareholder Agreement. Court action fighting the abrogation has been dragging on in state courts since then. In January 2004, SANEPAR undertook a debt-for-equity swap with the state government that diluted the minority shareholders' stakes.

French (and Spanish) Connection  
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[13.](#) (SBU) Embossos met November 12 with French Embassy Economic Minister Patrick Berger, Commercial Counselor Marie-Cecile Tardieu-Smith, and Financial Counselor, Roger Jean Belbenoit, to discuss the Sanepar case. Berger explained that the French Embassy has been advocating on behalf of Vivendi in the Sanepar case for some time. The French Ambassador wrote letters to, and met with, Finance Minister Palocci, the Minister of Cities and Governor Requiao himself to protest Requiao's actions. However, Governor Requiao had not given the French Ambassador any satisfaction, while the GoB told the French (as they have told us) that it has no legal leverage over the governor.

[14.](#) (SBU) Vivendi, according to Berger, has decided to sell its interest in to its Spanish partner, FCC. Berger said the French Embassy would nevertheless be interested in a joint approach with the US and the Spanish Embassies to press for GoB action in the case. Berger suggested that the three Ambassadors send a letter to the Minister of Finance emphasizing the damage to Brazil's investment climate that Requiao was causing. Berger agreed it would be useful to send a copy to the CVM. Berger nevertheless opined that he felt that it was very unlikely that the GoB will take any action.

Comment  
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[15.](#) (SBU) We believe that the GoB is correct when it claims it has no legal grounds to intervene to overturn Governor Requiao's abrogation of the Shareholders' Agreement. Moreover, the legal recourse has not yet been exhausted.

This leaves the GoB only moral and political suasion to use to challenge Requirio, unfortunately a weapon to which he seems immune. That said, the attempt should be made and a joint approach with the French and Spanish to the GoB that emphasizes the investment climate damage Requirio is causing is our best shot at a GoB political-level effort. Raising the potential impact of this case on the GoB's ability to launch successfully the private public partnership program may find some resonance with the GoB given its urgent need to rebuild decaying infrastructure, including infrastructure that supports export expansion. There should be a parallel approach, led by the private shareholders, to challenge with the CVM to the dilution of the private shareholders' equity. Copying the three Ambassadors' letter to the CVM could usefully reinforce the private shareholders' approach.

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